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Cases, Regulations and Statutes

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qualified real property must be "... designated in the agreement referred to in subsection (d)(2)." Therefore, the first step in evaluating the risks from post-election sales or other dispositions of property is to check the election and the agreement of personal liability filed with the election[17] to see if the real property the owner wants to sell – (1) was subject to the election and (2) was listed in the agreement of personal liability. If the answer to both questions is no, a sale or other disposition of the property included in the estate but not included in the election or agreement of personal liability should not cause recapture.

The regulations that have been issued[18] support this position in that the regulation states that "an election under section 2032A need not include all real property included in the estate which is eligible for special use valuation, but sufficient property to satisfy the threshold requirements of section 2032A must be specially valued under the election." Two Technical Advice Memoranda are in agreement. The first TAM[19] states that an election can be made for less than all of the decedent's property (one of three tracts). The other TAM[20] states that ". . . section 2032A does not indicate that all qualified property included in the decedent's estate must be specially valued before any such property is so valued. . . . " The TAM goes on to state that sufficient property to satisfy the thresholds must be specially valued and it is possible to elect special use valuation *for less than all of the qualified real property."*[21] Moreover, the regulations state that the agreement of personal liability must express consent to collection of any additional estate tax imposed under section 2032A(c) from the qualified real property."[22]

In conclusion

Therefore, based on the authority to date, it would seem that a sale or other disposition of real property not subject to a special use valuation election and not listed in the agreement of personal liability should not trigger recapture of federal estate tax.

ENDNOTES

[1] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 302(a), amending I.R.C. §§ 2010, 2001(b)(2)(B).

[2] I.R.C. § 2010(c). See generally 5 Harl, *Agricultural Law* § 44.05[3] (2010); Harl, *Agricultural Law Manual* § 5.04[5][c] (2010 ed.).

[3] Pub. L. No. 111-312, § 303, amending I.R.C. § 2010(c).

[4] I.R.C. § 2032A.

[5] Rev. Proc. 2010-40, § 3.20, 2010-2 C.B. 663.

[6] I.R.C. §§ 2032A(c), 2032A(b)(1)(D).

[7] I.R.C. § 2057.

[8] See Harl, "Recapture Under FOBD," 12 *Agric. L. Dig.* 161 (2001).

[9] I.R.C. § 2057(j). However, that section was subject to the sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16.

[10] Pub. L. No. 107-16, § 521(d).

[11] See I.R.C. § 2057(f)(1)(B). See also Harl, "Recapture Under FOBD," 12 *Agric. L. Dig.* 161 (2001).

[12] I.R.C. § 2057(f)(1).

[13] I.R.C. § 2032A(c)(1)(A), (B).

[14] Three sets of regulations have been issued – Treas. Reg. § 20.2032A-3 (material participation); Treas. Reg. § 20.2032A-4 (method of valuing farm real property); and Treas. Reg. § 2032A-8 (election and agreement).

[15] I.R.C. § 2032A(c) (Emphasis added).

[16] I.R.C. § 2032A(b)(1)(D).

[17] The agreement of personal liability is referred to in I.R.C. § 2032A(d)(2) as follows – "The agreement referred to in this paragraph is a written agreement signed by each person in being who has an interest . . . in any property designated in such agreement consenting to the application of subsection (c) [pertaining to recapture] with respect to such property."

[18] Treas. Reg. § 20.2032A-8(a)(2).

[19] TAM 8040016, June 30, 1980.

[20] 8045017, July 30, 1980.

[21] TAM 8045017, July 30, 1980.

[22] Treas. Reg. § 20.2032A-8(c)(1).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

AUTOMATIC STAY. The debtor owned a leasehold interest in two standardbred race horses. The horses were boarded at two stables and trained by two trainers. The boarding stables and trainers had not been paid for their services at the time the debtor filed for Chapter 7 bankruptcy. After notice of the bankruptcy filing, the trainers conducted stableman's lien sales of the horses under N.J.S.A. §§2A:44-51 to 2A:44-52. The debtor claimed that the sales terminated its leasehold interest in the horses in violation of the automatic stay. The court agreed, holding that the sales violated the automatic stay until the Chapter 7 trustee rejected the horse leases. **In re Theokary, 2011 Bankr. LEXIS 507 (Bankr. E.D. Penn. 2011)**.

FEDERAL TAX

SALE OF CHAPTER 12 PROPERTY. The debtors, husband and wife, were dairy farmers who filed for Chapter 12 and obtained a confirmed plan. The plan provided for continuation of the farming operations and stated that title to all property remained with the debtors. The plan did not provide for any sale of farm assets. Although the debtors were initially able to make all plan payments, an amended plan was proposed with lower payments. The debtors were still unable to make even the lower proposed plan payments and the debtors sought court approval for sale of all farm equipment and cattle. The court approved the sale with all proceeds paid to the trustee. The debtors sought a declaratory judgment that any capital gains taxed owed from the sale would be an unsecured claim. Although the Bankruptcy Court indicated an agreement with the Ninth Circuit's use of plain language interpretation in *In re Hall, United States v. Hall, 617 F.3d 1161 (9th Cir. 2010)*, the court rejected the holding that the tax from the sale of farm property was not a claim of the estate simply because no taxable estate was created in Chapter 12. The court found this interpretation to render the statute superfluous. Instead, the court focused on the facts that the sale was to occur post-confirmation of the plan and that the plan did not provide for any sale of farm property. The court rejected the debtors' attempt to amend the plan to fix these problems, holding that such a modification was not allowed under Section 1229(a). Thus, the court held that the capital gains tax resulting from the sale of the Chapter 12 debtors' property could not be granted unsecured claim status under the confirmed plan. **In re Smith 2011-1 U.S. Tax Cas. & 50,288 (Bankr. W.D. Penn. 2011)**.

FEDERAL FARM PROGRAMS

NATIONAL ORGANIC PROGRAM. The USDA has adopted as final regulations which amends the National List of Allowed and Prohibited Substances to incorporate a recommendation submitted to the Secretary of Agriculture by the National Organic Standards Board (NOSB) on April 29, 2010. Consistent with the recommendation from the NOSB, the final rule revises the annotation of one substance on the National List, methionine, to extend its use in organic poultry production until October 1, 2012. **76 Fed. Reg. 13501 (March 14, 2011)**.

FEDERAL ESTATE AND GIFT TAXATION

APPLICABLE EXCLUSION AMOUNT. The U.S. Congress Joint Committee on Taxation has issued the following correction to the Blue Book on 2010 Legislation: "1. On page 555, add the following footnote 1582A to the word "amount" in the next to last sentence in example 3: The provision adds new section 2010(c)(4), which generally defines "deceased spousal unused exclusion amount" of a surviving spouse as the lesser of (a) the basic exclusion amount, or (b) the excess of (i) the basic exclusion amount of the last deceased spouse of such surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse. A technical correction may be necessary to replace the reference to the basic exclusion amount of the last deceased spouse of the surviving spouse with a reference to the applicable exclusion amount of such last deceased spouse, so that the statute reflects intent. Applicable exclusion amount is defined in section 2010(c)(2), as amended by the provision." **JCX-20-11**.

CHARITABLE DEDUCTION. The decedent had executed several wills over several years and each of these wills included a residuary bequest to a charitable organization. However, the decedent's final will did not have any bequest for the residuary estate. The decedent's attorney testified that the omission was a scrivener's error only. The decedent's heir claimed that the residuary estate passed by intestacy to the heir and the parties reached a settlement with two-thirds of the residuary estate passing to the charitable organization. The estate claimed a charitable deduction for that amount but the IRS denied the deduction under I.R.C. § 2055 because the charitable organization had no right under the will to the residuary estate property. The court disagreed and held that the settlement amount was consistent with the intent of the decedent and was reached in arm's length negotiations. **Estate of Palumbo v. United States, 2011-1 U.S. Tax Cas. (CCH) ¶ 60,616 (W.D. Penn. 2011)**.

GENERATION SKIPPING TRANSFERS. The taxpayer and spouse formed five trusts for their five children. The trusts were funded with cash. The taxpayers relied on an accountant to prepare the Form 709 gift tax return in which the taxpayers elected to treat the transfer of property to the trusts as a joint gift. When the accountant prepared the Form 709, the accountant failed to allocate the taxpayers' available GSTT exemptions to the transfers to the trusts. The IRS granted an extension of time to file amended returns with the allocation of the GSTT exemption. **Ltr. Rul. 201111004, Nov. 22, 2010**.

TRANSFERS WITH RETAINED INTERESTS. The decedent had created a qualified personal residence trust and transferred the decedent's residence to the trust. The trust provided that, if the trust terminated before the death of the decedent, the trust property passed to two trusts for the decedent's two children. After consultation with estate planners, the decedent realized that the decedent would have to pay rent to the two trusts if the decedent lived in the residence after termination of the QPRT. The QPRT terminated six months before the decedent died but the QPRT did not transfer title to the two remainder trusts. One child did ask counsel about determining fair market rental of the residence but no further effort was made and no rent was paid until administration of the decedent's estate. The court believed the parties that the decedent intended to pay fair market rent for the residence but that they had merely not begun the rent payment process when the decedent died. The court held that the residence was not estate property under I.R.C. § 2036 because the decedent did not retain an implied right to reside in the residence after termination of the QPRT. **Estate of Riese v. Comm'r, T.C. Memo. 2011-60**.

FEDERAL INCOME TAXATION

CAPITAL GAINS. The taxpayer was a real estate professional. During a previous marriage, the taxpayer's ex-spouse, also a real estate professional, purchased rental real property in the spouse's sole name. A one-half interest was later transferred to the taxpayer. In divorce proceedings, the ex-spouse was ordered to transfer the remaining interest in the property to the taxpayer. The ex-spouse had paid $320,000 for the property. The taxpayer sold the property for $700,000 eight years later and claimed capital gain income from the sale based on a basis of $500,000. The basis was determined for purposes of a depreciation deduction in consultation with a tax return preparer in the year the property was fully acquired in the divorce. The taxpayer made no other attempt to determine the fair market value or basis of the property. The court held that the initial cost basis of $320,000 carried over to the initial gift transfer to the taxpayer and to the second transfer under the divorce decree; therefore, the taxpayer's basis in the property remained the initial cost basis of $320,000. The court also sustained assessment of the accuracy-related penalty, noting that the taxpayer, as a real estate professional, should have known how to properly determine the tax basis of the property. **Parsley v. Comm'r, T.C. Summary Op. 2011-35**.

CASUALTY LOSS. The taxpayer was a shareholder in a cooperative housing corporation and leased an apartment in a building owned by the corporation, under an entitlement established by the taxpayer's ownership of the stock. A retaining wall owned by the corporation collapsed and the corporation assessed all shareholders their share of the costs of the collapse. The taxpayer claimed a casualty deduction for the taxpayer's share of the assessment. The court held that the taxpayer was not entitled to a casualty loss deduction because the taxpayer did not own the property which was damaged by the collapse. **Alphonso v. Comm'r, 136 T.C. No. 11 (2011)**.

EMPLOYEE BUSINESS EXPENSES. The IRS has published information on determining which expenses may be deducted as an employee business expense. Expenses that qualify for an itemized deduction include: business travel away from home; business use of car; business meals and entertainment; travel; use of the employee's home; education; supplies; tools; and miscellaneous expenses. A taxpayer must keep records to prove the business expenses a taxpayer can deduct. For general information on recordkeeping, see IRS Publication 552, Recordkeeping for Individuals. If the taxpayer's employer reimburses the taxpayer under an accountable plan, the taxpayer does not include the payments in the taxpayer's gross income, and the taxpayer may not deduct any of the reimbursed amounts. An accountable plan must meet three requirements: (1) the taxpayer must have paid or incurred expenses that are deductible while performing services as an employee; (2) the taxpayer must adequately account to the taxpayer's employer for these expenses within a reasonable time period; and (3) the taxpayer must return any excess reimbursement or allowance within a reasonable time period. If the plan under which the employee is reimbursed by the employer is non-accountable, the payments the taxpayer receives should be included in the wages shown on the taxpayer's Form W-2. A taxpayer must report the income and itemize the taxpayer's deductions to deduct these expenses. Generally, report expenses on IRS Form 2106 or IRS Form 2106-EZ to figure the deduction for employee business expenses and attach it to Form 1040. Deductible expenses are then reported on Form 1040, Schedule A, as a miscellaneous itemized deduction subject to 2% of the taxpayer's adjusted gross income rules. Only employee business expenses that are in excess of 2% of the taxpayer's adjusted gross income can be deducted. For more information see IRS Publication 529, *Miscellaneous Deductions*. **IRS Tax Tip 2011-54**.

FARM DEDUCTIONS. The IRS has published a summary of ten deductions for farmers. *Crop Insurance Proceeds*. Farmers must include in income any crop insurance proceeds received as the result of crop damage. Farmers generally include them in the year received. *Sales Caused by Weather-Related Condition*. In general, if a farmer sells more livestock, including poultry, than the farmer normally would in a year because of weather-related conditions, the farmer may be able to postpone reporting the gain from selling the additional animals due to the weather until the next year. *Farm Income Averaging*. Farmers may be able to average all or some of their current year's farm income by allocating it to the three prior years. This may lower the current year tax if the current year income from farming is high, and the taxable income from one or more of the three prior years was low. This method does not change the prior year tax, it only uses the prior year information to determine the current year tax. *Deductible Farm Expenses*. The ordinary and necessary costs of operating a farm for profit are deductible business expenses. An ordinary expense is an expense that is common and accepted in the farming business. A necessary expense is one that is appropriate for the business. *Employees and Hired Help*. Farmers can deduct reasonable wages paid for labor hired to perform farming operations. This includes full-time and part-time workers. Farmers must withhold social security, medicare and income taxes on employees. *Items Purchased for Resale*. Farmers may be able to deduct, in the year of the sale, the cost of items purchased for resale, including livestock and the freight charges for transporting livestock to the farm. *Net Operating Losses*. If a farmer's deductible expenses from operating the farm are more than your other income for the year, the farmer may have a net operating loss. Farmers can carry that loss over to other years and deduct it. Farmers may get a refund of part or all of the income tax paid for past years, or may be able to reduce the tax in future years. *Repayment of Loans*. Farmers cannot deduct the repayment of a loan if the loan proceeds are used for personal expenses. However, if a farmer uses the proceeds of the loan for the farming business, a farmer can deduct the interest paid on the loan. *Fuel and Road Use*. Farmers may be eligible to claim a credit or refund of federal excise taxes on fuel used on a farm for farming purposes. *Farmer's Tax Guide*. More information about farm income and deductions is in IRS Publication 225, *Farmer's Tax Guide*. **IRS Tax Tip 2011-56.** [NOTE: the Tax Tip does not mention that crop insurance proceeds and disaster assistance payments can be carried over to the year after the year of destruction or damage to the crops under I.R.C. § 451(d). Also, under Net Operating Losses, it is not mentioned that "farming losses" can be carried back five years.]

GOODWILL. The taxpayer owned and operated an automobile dealership which had franchises with several automobile manufacturers. One manufacturer terminated the franchise rights for its automobiles. The taxpayer sought to deduct the loss of goodwill for those franchises. In a Field Attorney Advice letter, the IRS ruled that, under I.R.C. § 197(f)(1), the value of the goodwill lost in the termination had to be added to the basis of other I.R.C. § 197 amortizable intangibles still owned by the taxpayer and could not be deducted. **FAA 20111101F, Feb. 15, 2011**.

HEALTH INSURANCE. The IRS has published information about a special tax deduction for the self-employed. Taxpayers may be able to deduct premiums paid for medical and dental insurance and qualified long-term care insurance for the taxpayer, the taxpayer's spouse, and the taxpayer's dependents if the taxpayer is one of the following: (1) A self-employed individual with a net profit reported on Schedule C (Form 1040), Profit or Loss From Business, Schedule C-EZ (Form 1040), Net Profit From Business, or Schedule F (Form 1040), Profit or Loss From Farming; (2) a partner with net earnings from self-employment reported on Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc*., box 14, code A; or (3) shareholder owning more than 2% of the outstanding stock of an S corporation with wages from the corporation reported on Form W-2, Wage and Tax Statement. In order to be deductible, the insurance plan must be established under the taxpayer's business. For self-employed individuals filing a Schedule C, C-EZ, or F, the policy can be either in the name of the business or in the name of the individual. For partners, the policy can be either in the name of the partnership or in the name of the partner. The taxpayer can either pay the premiums or the partnership can pay them and report the premium amounts on Schedule K-1 (Form 1065) as guaranteed payments to be included in the taxpayer's gross income. However, if the policy is in the taxpayer's name and the taxpayer pays the premiums, the partnership must reimburse the taxpayer and report the premium amounts on Schedule K-1 (Form 1065) as guaranteed payments to be included in the taxpayer's gross income. Otherwise, the insurance plan will not be considered to be established under the taxpayer's business. For more-than-2% S corporation shareholders, the policy can be either in the name of the S corporation or in the name of the shareholder. The taxpayer can either pay the premiums or the S corporation can pay them and report the premium amounts on Form W-2 as wages to be included in the taxpayer's gross income. However, if the policy is in the taxpayer's name and the taxpayer pays the premiums, the S corporation must reimburse the taxpayer and report the premium amounts on Form W-2 as wages to be included in the taxpayer's gross income. Otherwise, the insurance plan will not be considered to be established under the taxpayer's business. For more information see IRS Publication 535, *Business Expenses*. **IRS Tax Tip 2011-51**.

INCOME FOR MINORS. The IRS has published information about the tax rules that affect taxpayer's children's investment income to help parents determine whether their child's investment income will be taxed at the parents' rate or the child's rate: (1) *Investment Income*. Children with investment income may have part or all of this income taxed at their parents' tax rate rather than at the child's rate. Investment income includes interest, dividends, capital gains and other unearned income. (2) *Age Requirement*. The child's tax must be figured using the parents' rates if the child has investment income of more than $1,900 and meets one of three age requirements for 2010: (a) was under age 18 at the end of the year, (b) was age 18 at the end of the year and did not have earned income that was more than half of his or her support, or (c) was a full-time student over age 18 and under age 24 at the end of the year and did not have earned income that was more than half of his or her support. (3) *Form 8615*. To figure the child's tax using the parents' rate for the child's return, taxpayers fill out Form 8615, Tax for Certain Children Who Have Investment Income of More Than $1,900, and attach it to the child's federal income tax return. (4) *Form 8814*. When certain conditions are met, a parent may be able to avoid having to file a tax return for the child by including the child's income on the parent's tax return. In this situation, the parent would file Form 8814, *Parents' Election To Report Child's Interest and Dividends*. More information can be found in IRS Publication 929, *Tax Rules for Children and Dependents*. **IRS Tax Tip 2011-52**.

INNOCENT SPOUSE. The taxpayer and spouse had operated an import business and used company funds to pay personal expenses. The couple filed joint returns for two years in which no income was reported. The taxpayer was found guilty of tax fraud and evasion for substantial under reporting of taxable income. The taxpayer sought innocent spouse relief which was denied by the IRS. The court found that the taxpayer was personally involved in the business and the filing of the income tax returns and was personally aware of the under reporting of taxable income; therefore, the taxpayer was not entitled to innocent spouse relief which was properly denied by the IRS. The appellate court affirmed in a decision designated as not for publication. **Taylor v. Comm'r, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,291 (9th Cir. 2011), *aff'g*, T.C. Memo. 2008-193**.

INVESTMENT INCOME. Taxpayers, husband and wife, timely filed a Form 1040 and included Form 4952, Investment Interest Expense Deduction, with the original tax return. On the Form 4952, the taxpayers elected to treat some of their of net capital gain as investment income in order to offset the full amount of investment interest expense. The IRS conducted an examination of the taxpayers' tax return, and as a result of the examination, the IRS increased the amount of the taxpayers' capital gain and investment interest. Due to the adjustments, the amount of investment income converted from net capital gain originally elected was insufficient to allow a deduction for the amount of investment interest expense claimed. The taxpayers requested an extension to modify the dollar amount of the election on Form 4952 to treat more net capital gain as investment interest income for the taxable year. The taxpayers requested permission to increase the amount of the election so that the amount of investment income elected allowed a deduction for additional investment interest expense increased due to the examination. The IRS granted the extension. **Ltr. Rul. 201110002, Dec. 2, 2010**.

INVOLUNTARY CONVERSIONS. The taxpayer was several affiliated corporations and partnerships operating a business. The operations of some of taxpayer's business units were damaged by the 2006 Gulf Coast hurricanes, which were Presidentially-declared disasters. The taxpayer received insurance and salvage proceeds relating to property involuntarily converted as a result of the hurricanes, more than half of which related to lost or damaged inventory. The taxpayer realized gain in excess of basis from these recoveries. The taxpayer reinvested most of the insurance and salvage proceeds in new store construction property and included statements in its tax returns that identified the replacement property. The taxpayer also reduced the basis of the new property by the amount of the deferred gain. The taxpayer expected to reinvest the remaining proceeds within the five-year replacement period for property damaged by Hurricane Katrina. Under I.R.C. § 1033(h)(2), if a taxpayer's property held for productive use in a trade or business or for investment is located in a disaster area and is compulsorily or involuntarily converted as a result of a federally declared disaster, then tangible property held for productive use in a trade or business is treated as property similar or related in service or use to the converted property. The IRS ruled that the taxpayer's destroyed inventory was "property held for productive use in a trade or business or for investment" eligible for involuntary conversion treatment. **Ltr. Rul. 201111004, Dec. 13, 2010**.

PARTNERSHIPS

ADMINISTRATIVE ADJUSTMENTS. The taxpayer was a partner in a limited partnership. The partnership filed its 1999 federal tax return on April 20, 2000, showing a net loss. The taxpayer filed a personal income tax return which included the taxpayer's share of the partnership loss. In December 2004, the IRS issued a notice of final partnership administrative adjustment (FPAA) which adjusted the partnership basis in property such that the net loss was reduced. The taxpayer filed an objection to the FPAA as untimely filed past the three year statute of limitations provided by I.R.C. § 6229(a). The IRS argued that the extended six-year statute of limitations of I.R.C. § 6501(e)(1)(A) allowed the filing of the FPAA. The trial court held that, because the original partnership return included the basis item, the extended six year limitation period did not apply and the FPAA had to be filed within three years; therefore, the FPAA was invalid and the court had no jurisdiction to enforce it. In 2010, the IRS adopted final regulations which stated: "an understatement of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of 6501(e)(1)(A)." Treas. Reg. §301.6229(c)(2)-1(a)(1)(iii). On appeal the appellate court reversed, holding that the regulations were a reasonable interpretation of the statute and could be applied retroactively to impose the six year statute of limitation. **Grapevine Imports, Ltd. v. United States, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,264 (Fed. Cir. 2011),** ***rev'g and rem'g*****, 2007-2 U.S. Tax Cas. (CCH) ¶ 50,555 (Fed. Cls. 2007)**.

PASSIVE ACTIVITY LOSSES. The taxpayers, husband and wife, were employed as an engineer and nurse, with $133,117 and $167,630 in wages over two years. The husband also engaged in real estate activities in purchasing, renovating, managing and selling rental properties. The taxpayers claimed loss deductions from the real estate activities which were denied by the IRS. During the IRS audit, the taxpayers claimed that the husband spent 800 hours per year on the real estate activities; however, during trial the taxpayers changed the number to 1950 hours after being told that I.R.C. § 469(c)(7) also required that the husband spend more time at the real estate activities than the job as engineer in order for the husband to be treated as a real estate professional. The inconsistency led the court to disbelieve the husband's trial court testimony and the court held that the husband's rental activities were passive. However, the court held that the husband's participation was active because of the substantial time and effort personally spent on the activities; therefore, the taxpayer's were eligible, under I.R.C. § 469(i)(3)(A), for up to $25,000 of passive loss deduction, subject to phase-out for incomes above $100,000. Because the taxpayer's incomes exceeded $100,000, the maximum $25,000 of deductible losses was reduced each year by 50 cents for each dollar of income over $100,000. **Anyika v. Comm'r, T.C. Memo. 2011-69**.

REFUNDS. The IRS has published information about tax refund offsets. If a taxpayer owes money because of certain delinquent debts, the IRS or the Department of Treasury's Financial Management Service (FMS), which issues IRS tax refunds, can offset or reduce the federal tax refund or withhold the entire amount to satisfy the debt. If a taxpayer owes federal or state income taxes, the refund will be offset to pay those taxes. If a taxpayer has other debt such as child support or student loan debt that was submitted for offset, FMS will take as much of the refund as is needed to pay off the debt, and send it to the agency authorized to collect the debt. Any portion of a refund remaining after an offset will be refunded to the taxpayer. A taxpayer will receive a notice if an offset occurs. The notice will reflect the original refund amount, the offset amount, the agency receiving the payment, and the address and telephone number of the agency. A taxpayer should contact the agency shown on the notice if the taxpayer believes the taxpayer does not owe the debt or the taxpayer is disputing the amount taken from the refund. If a taxpayer filed a joint return and the taxpayer is not responsible for the debt, but the taxpayer is entitled to a portion of the refund, the taxpayer may request the taxpayer's portion of the refund by filing IRS Form 8379, *Injured Spouse Allocation*. Attach Form 8379 to the original Form 1040, Form 1040A, or Form 1040EZ or file it by itself after notification of an offset. If a taxpayer files a Form 8379 with the return, write "INJURED SPOUSE" at the top left corner of the Form 1040, 1040A, or 1040EZ. IRS will process the allocation request before an offset occurs. If a taxpayer is filing Form 8379 by itself, it must show both spouses' social security numbers in the same order as they appeared on your income tax return. The taxpayer, the "injured" spouse, must sign the form. Taxpayers should not attach the previously filed Form 1040 to the Form 8379. Send Form 8379 to the Service Center where the taxpayer filed the original return. The IRS will compute the injured spouse's share of the joint return for the taxpayer. Contact the IRS only if the original refund amount shown on the FMS offset notice differs from the refund amount shown on the taxpayer's tax return. Taxpayers should follow the instructions on Form 8379 carefully and be sure to attach the required forms to avoid delays. If a notice is not received taxpayers should contact the Financial Management Service at 800–304–3107. **IRS Tax Tip 2011-59.**

The IRS has issued a Chief Counsel Advice letter discussing the statute of limitations for claims for refunds. The ruling notes two statutory limitations, I.R.C. § 6511(a) which requires a filing of a refund claim "within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires later." Under I.R.C. § 6532(a)(1), after a claim is timely filed, the taxpayer may file a lawsuit for a refund within two years after the IRS mails a notice to the taxpayer of a disallowance of part or all of the refund claim. The IRS ruled that, if the taxpayer fails to timely file a suit on the disallowed refund claim, the IRS and the Office of Appeals are prohibited by I.R.C. § 6514(a) from approving any refund. **CCA 201110011, Oct. 28, 2010**.

RETURNS. The IRS has issued a proposed regulation pertaining to the period for submission to the IRS of taxpayer authorizations permitting disclosure of returns and return information to third-party designees. The proposed regulation extends from 60 days to 120 days the period within which a signed and dated authorization must be received by the IRS (or an agent or contractor of the IRS) in order for it to be effective. The proposed regulation extends the period because some institutions charged with assisting taxpayers in their financial dealings have encountered difficulty in obtaining written authorizations and submitting the authorizations within the 60-day period allowed by the existing regulations. The proposed regulation will affect taxpayers who submit authorizations permitting disclosure of returns and return information to third-party designees. **76 Fed. Reg. 14827 (March 18, 2011)**.

SAFE HARBOR INTEREST RATES
April 2011

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	0.55	0.55	0.55	0.55
110 percent AFR	0.61	0.61	0.61	0.61
120 percent AFR	0.66	0.66	0.66	0.66
		Mid-term		
AFR	2.49	2.47	2.46	2.46
110 percent AFR	2.74	2.72	2.71	2.70
120 percent AFR	2.98	2.96	2.95	2.94
		Long-term		
AFR	4.25	4.21	4.19	4.17
110 percent AFR	4.68	4.63	4.60	4.59
120 percent AFR	5.11	5.05	5.02	5.00

Rev. Rul. 2011-10, I.R.B. 2011-14.

SELF-EMPLOYMENT INCOME. The taxpayer was employed as a boat's captain on a fishing boat. The proceeds from the boat's catch on a voyage were divided as follows: (1) The boat's expenses for fuel, ice, and lubricating oil were subtracted from the gross proceeds from the sale of the catch to determine the net proceeds from the voyage; (2) the crew members, including the captain, were allocated 50 percent of the net proceeds (the crew members' share); (3) the boat owner and the captain were allocated 50 percent of the net proceeds (the boat share); (4) the crew members' share was allocated among the crew members, including the captain, after subtracting the crew's expenses for food, payments to laborers employed to help unload the catch, and other miscellaneous items. In addition, before the proceeds were allocated between the crew members' and the boat shares, 1 percent of the gross proceeds from the sale of the catch was paid to trade associations that performed lobbying services for the fishing industry. The taxpayer also received payments for work on the boat's engine. The taxpayer reported the amounts paid on the federal income tax return as income from "commercial fishing not reported on W-2." No self-employment tax was reported or paid. The court held that, under I.R.C. § 3121(b)(20), the taxpayer's share of the fishing proceeds and payments for repair services were self-employment income. **Anderson v. Comm'r, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,286 (1st Cir. 2011), *aff'g*, T.C. Memo. 2010-1**.

STATE TAXATION

AGRICULTURAL USE. The taxpayers purchased a 15 acre farm of which 14 acres were in alfalfa production. The property traditionally had been subject to a bifurcated tax valuation, with the one acre homestead valued at full fair market value and the 14 acres exempt, under Idaho Code § 63-604(1), as land devoted to agriculture. The taxpayers argued that the homestead should also qualify as land devoted to agriculture. The Idaho Tax Commission regulations interpreted the statute to exclude the homesite which was defined as land not devoted to agriculture. The taxpayers argued that, because the homesite is included in determining whether a farm has sufficient acres, at least five acres, to qualify for the exemption, the statute includes the homesite in the acres devoted to agriculture exempt from tax. The court disagreed, holding that the statute was clear that only land devoted exclusively to agriculture was eligible for the exemption. **In the Matter of Kimbrough, 2011 Ida. LEXIS 21 (Idaho 2011)**.

IN THE NEWS

NEGLIGENCE. Indiana Governor Mitch Daniels has signed into law House Enrolled Act 1133 which protects agritourism businesses from lawsuits such that those entities cannot be held liable for injury to or death of participants in agriculture activities, as long as the agritourism business posts a notice at the entry point of the business notifying guests the business would not be liable for harm.

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by Neil E. Harl

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The topics include:

Tuesday, May 10, 2011

FARM INCOME TAX

New Legislation

Reporting Farm Income

- Leasing land to family entity
- Constructive receipt of income
- Deferred payment and installment payment arrangements for grain and livestock sales
- Payments from contract production
- Items purchased for resale
- Items raised for sale
- Crop insurance proceeds
- Weather-related livestock sales
- Sales of diseased livestock
- Reporting federal disaster assistance benefits
- Gains and losses from commodity futures

Claiming Farm Deductions

- Soil and water conservation expenditures
- Fertilizer deduction election
- Farm lease deductions
- Prepaid expenses
- Preproductive period expense provisions
- Regular depreciation, expense method depreciation, bonus depreciation
- Paying rental to a spouse
- Paying wages in kind
- Section 105 plans

Sale of Property

- Income in respect of decedent
- Sale of farm residence
- Installment sale including related party rules
- Private annuity
- Self-canceling installment notes
- Sale and gift combined.

Like-Kind Exchanges

- Requirements for like-kind exchanges
- "Reverse Starker" exchanges
- What is "like-kind" for realty
- Like-kind guidelines for personal property
- Partitioning property
- Exchanging partnership assets

Taxation of Debt

- Turnover of property to creditors
- Discharge of indebtedness
- Taxation in bankruptcy.

Wednesday, May 11, 2011

FARM ESTATE AND BUSINESS PLANNING

New Legislation

The Liquidity Problem

Property Held in Co-ownership

- Federal estate tax treatment of joint tenancy
- Severing joint tenancies
- Joint tenancy and probate avoidance
- Joint tenancy ownership of personal property
- Other problems of property ownership

Federal Estate Tax

- The gross estate
- Special Use Valuation
- Family-owned business deduction recapture
- Property included in the gross estate
- Traps in use of successive life estates
- Basis calculations under uniform basis rules
- Valuing growing crops
- Claiming deductions from the gross estate
- Marital and charitable deductions
- Taxable estate
- The unified credit and other credits
- Unified estate and gift tax rates
- Generation skipping transfer tax, including later GST consequences for transfers in 2010
- Basis for deaths in 2010
- Federal estate tax liens
- Undervaluations of property
- Reopening an examination

Gifts

- Reunification of gift tax and estate tax
- Gifts of property when debt exceeds basis

Use of the Trust

The General Partnership

Limited Partnerships

Limited Liability Companies

- Developments with passive losses
- Corporate-to-LLC conversions

The Closely-Held Corporation -

- State anti-corporate farming restrictions
- Developing the capitalization structure
- Tax-free exchanges
- Would incorporation trigger a gift because of severance of land held in joint tenancy?
- "Section 1244" stock

Status of the Corporation as a Farmer

- The regular method of income taxation
- The Subchapter S method of taxation

Financing, Estate Planning Aspects and Dissolution of Corporations

- Corporate stock as a major estate asset
- Valuation discounts
- Dissolution and liquidation

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